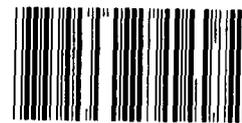
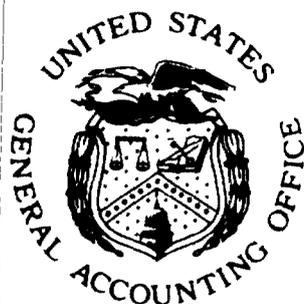

BY THE U.S. GENERAL ACCOUNTING OFFICE

**Report To The Administrator,
Small Business Administration**

**Small Business Administration's First-Year
Implementation Of The Federal Managers'
Financial Integrity Act**

GAO reviewed the processes used by 22 executive agencies to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations by requiring agencies to assess and report annually on the adequacy of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by SBA in its first year of experience with this new act. The report focuses on SBA's evaluation of internal controls, reviews of accounting systems, and the improvements it is making as a result of identified problems.



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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY,
AND ECONOMIC DEVELOPMENT
DIVISION

B-202205

The Honorable James C. Sanders
Administrator
Small Business Administration

Dear Mr. Sanders:

This report culminates our review of the processes that the Small Business Administration (SBA) used to implement the Federal Managers' Financial Integrity Act of 1982. This review was part of our government-wide assessment of 22 agencies' first year implementation of the act.

Section 2 of the act requires each federal agency to evaluate and report annually to the President and the Congress on the adequacy of its internal controls, and section 4 requires each agency to report whether its accounting systems conform to principles and standards prescribed by the Comptroller General.

Although SBA got a late start in implementing the act, it has made progress in recent months. On the basis of our review, we identified some weaknesses in the internal control evaluation and improvement process that SBA needs to address. Appendix I contains the details of SBA's progress in implementing the act, its proposed actions to correct identified weaknesses, and its response to our review results. The following summarizes the results of our work.

INTERNAL CONTROL EVALUATION PROCESS

In evaluating systems of internal control, the act requires agencies to adhere to guidelines developed by the Office of Management and Budget (OMB). The guidelines provide a basic approach for evaluating, improving, and reporting on internal controls and outline the following sequential process as an efficient, effective way to perform the required evaluations: (1) organizing the internal control evaluation process, (2) segmenting the agency by programs and/or functions to create an inventory of assessable units, (3) assessing the units for their vulnerability to waste, loss, unauthorized use or misappropriation, (4) evaluating internal controls within the units, (5) taking the necessary corrective actions to improve internal controls, and (6) reporting annually to the President and the Congress on the status of the agency's systems of internal control.

SBA's annual statement to the President and the Congress reported that SBA's system of internal controls in effect during the year ended September 30, 1983, taken as a whole, generally complies with the act's requirement that its system provide reasonable assurance that the stated internal control objectives are met. The statement cited 16 material weaknesses including the agency-wide need to update, strengthen, and streamline its standard operating procedures which prescribe SBA's managerial control policies and procedures for each program and administrative function.

In its first-year effort, SBA issued an internal control directive that assigns responsibilities for the internal control evaluation and improvement process. Additionally, SBA managers segmented the agency and did vulnerability assessments for 65 assessable units in December 1982. Also, as required by the OMB guidelines, SBA did internal control reviews on two of its programs during the first year. However, in our review of SBA's first-year implementation of the act, we found that SBA:

- Carried out its first-year internal control efforts without a long-range plan or agenda on how it would comply with the act's requirements. Although not required by the OMB guidelines, such a plan can be a useful management tool when an agency with limited resources has a substantial amount of work to complete.
- Did not adequately document the segmentation and vulnerability assessment phases of its internal control review process. For example, while SBA ranked its multi-billion dollar Portfolio Management function as moderately vulnerable, SBA's review file did not contain sufficient documentation to support the rating. We believe the documentation should be such that an independent reviewer could, after examining available documentation, reach the same conclusion as the original reviewer.
- Does not have a procedures manual on how to do vulnerability assessments and internal control reviews. The OMB guidelines state that a procedures manual may be useful, and we believe that as SBA expands the process agency-wide, such a manual will help ensure a uniform approach to performing assessments and reviews.
- Did not adequately evaluate internal controls relating to automated systems, even though SBA is highly dependent on such systems to carry out its mission. OMB guidelines provide that agencies should include a review of automated systems when evaluating internal controls.

--Does not have an agency-wide system which logs and tracks internal control recommendations and planned corrective actions. OMB guidelines require agencies to establish such a system to help them manage the overall internal control evaluation process and facilitate preparation of the annual statement to the Congress and the President.

In carrying out the act and the OMB guidelines, SBA used an existing Regional Technical Review system--recently renamed the Computerized Internal Control Review (CICR) system. Under this system, SBA regional office teams annually review district offices' compliance with internal controls reflected in SBA's Standard Operating Procedures. Review results are then entered into a computer for analysis and reporting purposes. SBA is modifying the CICR system so that it can increasingly rely on the system for internal control evaluations. Because the system does not currently meet all OMB requirements, SBA should coordinate modifications to the system with OMB and obtain OMB's approval of its usage.

ACCOUNTING SYSTEM COMPLIANCE EVALUATION

SBA has evaluated its accounting systems. On the basis of efforts by both the Inspector General's office and the Office of the Comptroller, the Comptroller certified that, generally, SBA's accounting systems comply with the Comptroller General's requirements.

AGENCY COMMENTS

In providing official oral comments on a draft of this report, SBA generally agreed with our findings, conclusions, and proposed corrective actions contained in that draft and indicated that it is taking actions to address our concerns. Therefore, we have not included any recommendations in this report, but we plan to monitor SBA's progress in these areas as part of our continuing reviews of federal agencies' implementation of the Federal Managers' Financial Integrity Act.

As SBA makes further progress in implementing the internal control and accounting system requirements of the act and in correcting known weaknesses, and as it makes the improvements it has planned, SBA should have a more meaningful basis for concluding as to whether its internal controls and accounting systems meet the objectives of the act.

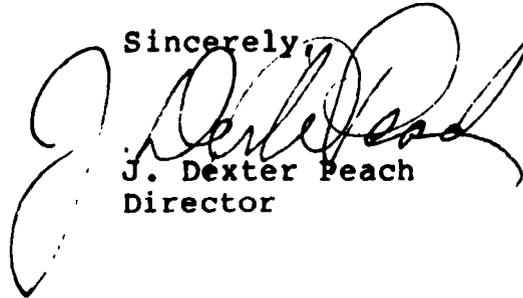
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We appreciate the cooperation and assistance provided by SBA officials throughout our review. We would like to particularly

thank the Director, Office of Program Analysis and Review, and his staff for their assistance.

We are sending copies of this report to the House Committee on Government Operations, the Senate Committee on Governmental Affairs, the House and Senate Committees on Appropriations, the House and Senate Committees on Small Business, and the Director, Office of Management and Budget.

Sincerely,

A handwritten signature in black ink, appearing to read "J. Dexter Peach". The signature is written in a cursive style with a large initial "J" and a long, sweeping underline.

J. Dexter Peach
Director

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ABBREVIATIONS

ADP	automatic data processing
CICR	computerized internal control review
CLP	Certified Lenders Program
FMFIA	Federal Managers' Financial Integrity Act
FY	fiscal year
GAO	General Accounting Office
MESBIC	Minority Enterprise Small Business Investment Company
OMB	Office of Management and Budget
PASS	Procurement Automated Source System
SBA	Small Business Administration
SBDC	Small Business Development Center
SBIC	Small Business Investment Company
SOP	Standard Operating Procedures

SBA'S FIRST-YEAR IMPLEMENTATION OF THE FEDERAL
MANAGERS' FINANCIAL INTEGRITY ACT

INTRODUCTION

Responding to continuing disclosures of fraud, waste, and abuse across a wide spectrum of government operations, largely attributable to serious weaknesses in agencies' internal controls, the Congress enacted the Federal Managers' Financial Integrity Act, 31 U.S.C. 3512(b) and (c), in 1982. The act strengthens the existing requirement of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control designed to provide effective control over and accountability for all funds, property, and other assets for which the agency is responsible (31 U.S.C. 3512(a)(3)).

We believe that full implementation of the Financial Integrity Act will enable federal department and agency heads to identify their major internal control and accounting problems and provide a systematic framework upon which to develop an effective management control system and a sound financial management structure for their agency.

The act requires:

- Each agency to establish and maintain its internal controls in accordance with the standards prescribed by the Comptroller General,¹ so as to reasonably assure that: (1) obligations and costs comply with applicable law, (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.
- Each agency to evaluate and submit a statement annually on whether the agency's systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency statements to identify any material weaknesses and describe the plans for corrective action.
- Each agency to prepare a separate report as part of its annual statement on whether the agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General.

¹The Comptroller General issued "Standards for Internal Controls in the Federal Government" in June 1983.

--The Office of Management and Budget (OMB) to issue guidelines for federal departments and agencies to use in evaluating their internal control systems. These guidelines were issued in December 1982.

OMB's internal control guidelines outline the following seven-phase approach to be used by agencies for evaluating, improving, and reporting on their internal controls:

1. Organizing the internal control evaluation process, including the assignment of responsibilities for planning, directing, and controlling the process, and the development of an information system to monitor and track the status of the evaluations and corrective actions.
2. Segmenting the agency to identify assessable units--i.e., organizational components, programs, and functions.
3. Assessing the vulnerability of each assessable unit to fraud, waste, and abuse.
4. Developing plans for performing internal control reviews and other actions, based on the results of the vulnerability assessments.
5. Performing internal control reviews to determine whether adequate control objectives have been established and control techniques exist and are functioning as intended, and then developing recommendations to correct weaknesses in either the design or functioning of the internal control system.
6. Determining, scheduling, and taking the necessary corrective actions for improving internal controls.
7. Preparing the annual statement to the President and the Congress on the status of the agency's systems of internal control.

This report on the Small Business Administration (SBA) is 1 of 22 reports on the processes executive agencies are using to implement the act.

OBJECTIVE, SCOPE, AND METHODOLOGY

The overall objective of our review, conducted between July 1983 and January 1984, was to assess SBA's processes for evaluating its internal control and accounting systems for reporting under the act. Because we limited our first-year review to evaluating SBA's implementation process, we did not independently determine the status of its internal control system or the extent to which its accounting systems comply with the Comptroller General's principles and standards.

Our assessment of SBA's process for evaluating its internal control system included discussions with SBA central office internal control officials, the Assistant Inspector General for Audit, and selected SBA staff involved in implementing the act. We also discussed the SBA process with cognizant OMB officials, and we analyzed pertinent documentation on SBA's process, including information on its vulnerability assessments for 65 assessable units and its internal control reviews of the 503 Certified Development Company Program and the Disaster Assistance Program. We also reviewed documentation on SBA's modification of its Computerized Internal Control Review (CICR) system, and we compared SBA's internal control improvement process with the requirements of the OMB guidelines. Finally, we examined SBA's process for evaluating its internal controls relating to automatic data processing (ADP) activities, given the critical role ADP plays in SBA's programs.

Our review of SBA's accounting systems' evaluation included discussions with SBA's Comptroller and his staff to identify the process used by SBA. We reviewed two recent Inspector General reports on SBA's accounting systems and verified corrective actions that SBA took in response to the reports' findings. Furthermore, we reviewed enhancement projects which SBA currently has underway on two of its major accounting systems.

We reviewed SBA's annual statements to the President and the Congress. We documented weaknesses identified in prior GAO and Inspector General reports and compared them with the material weaknesses identified in SBA's statements. We also compared the reported material weaknesses with instances of non-compliance with SBA Standard Operating Procedures which were reported out of the CICR system in 1983, and with internal control weaknesses reported by program officials to the SBA Administrator in 1983.

Our work was conducted in accordance with generally accepted government auditing standards.

SBA'S ORGANIZATION AND OPERATIONS

The Congress created SBA in 1953 to assist small businesses through various financial, procurement, and management assistance programs. For example, under its financial assistance efforts, SBA guarantees loans to small businesses that are unable to obtain private financing without the guaranty. Under the guaranty plan, SBA agrees to purchase the guaranteed portion of the loan from the private lender if the borrower defaults. Additionally, SBA has (1) procurement assistance activities that are aimed at assuring that small businesses receive a fair share of government procurements and (2) management assistance programs to help small business owners improve the management and efficiency of their businesses.

SBA has over 4,900 employees. It delivers most of its programs through a network of 66 district and 21 branch offices which report to its 10 regional offices. SBA has asked for \$569.1 million in its fiscal year 1985 budget request, and it currently has an outstanding loan portfolio of about \$16 billion.

SBA'S INTERNAL CONTROL EVALUATION AND IMPROVEMENT PROCESS

SBA has made recent progress in its efforts to comply with the Federal Managers' Financial Integrity Act (FMFIA) of 1982. While some activity was carried out in 1982 and early 1983, most of SBA's efforts regarding internal control evaluation and improvement took place during the latter half of calendar year 1983.

SBA's FMFIA efforts began with the issuance of a general internal control directive in March 1982. Also, in March the Acting Administrator established an Internal Control Steering Committee to oversee the FMFIA process. During the last 2 weeks of 1982, vulnerability assessments were performed on 65 assessable units identified by SBA managers. During the latter half of 1983, SBA increased its efforts because OMB was concerned that SBA was not making progress.

In March 1983, SBA's senior internal control official assigned the day-to-day responsibility for internal control coordination to the Assistant Administrator for Administration. SBA undertook a number of FMFIA activities both under his direction and his successor's. In September 1983, the Administrator transferred the day-to-day internal control evaluation coordination responsibilities to the Director, Office of Program Analysis and Review. This office reports to the Associate Deputy Administrator for Resource Management, who is currently SBA's senior internal control official.

When the Assistant Administrator for Administration was assigned day-to-day internal control responsibility in March 1983, he decided that SBA's FMFIA process needed an entirely new approach. Although central office program managers had documented and reported on vulnerability assessments during the last 2 weeks of 1982, the Assistant Administrator did not have much confidence in their completeness or quality primarily because the assessments did not include SBA field office operations. The agency had segmented by requesting top management officials to identify all programs and/or administrative functions within their areas of responsibility.

In August 1983, SBA issued a revised internal control directive. During that same month, SBA's Internal Control Steering Committee met to decide the areas that should be given internal control reviews by SBA during 1983. The committee decided that SBA should review two loan programs--the 503 Certified Development Company Program (503 Program) and the Disaster Assistance

Program (Disaster Program). SBA assembled and trained a task force to review the 503 Program. The internal control coordinator hoped that the structured 503 program internal control review could be used as a model for future SBA internal control reviews. The Disaster Program internal control review was less structured and was assigned to an individual within the Disaster Assistance Division. The results of these reviews had not been summarized and reported to the internal control coordinator at the time SBA issued its annual statement² in December 1983. These reports were completed in February 1984.

SBA did not rely on the December 1982 vulnerability rankings of the 65 assessable units, and at a December 8, 1983, meeting, the Steering Committee reconsidered the rankings, increasing the number of highly vulnerable areas from 3 to 12. At this meeting, the committee members also reviewed district office internal control compliance information included in reports generated by the CICR system discussed below.

A major FMFIA-related effort is SBA's modification of CICR to support the FMFIA process. Under CICR, SBA regional office teams annually review SBA's 66 district offices and some of its 21 branch offices for compliance with internal controls in SBA's Standard Operating Procedures. Approximately 600 control checklist items are tested for compliance at each office. The review teams then enter the results of these reviews into a computer for analysis and reporting.

SBA started to modify this system in the latter half of 1983 to make it more consistent with the requirements of the OMB guidelines, and it plans further changes in 1984. One of the 1983 changes was SBA's assignment of an inherent risk factor to each of the checklist items in the system.

SBA's Office of Inspector General has participated in the internal control review and improvement process. The Assistant Inspector General for Audit is an advisory member of SBA's Internal Control Steering Committee. Additionally, the Office of Inspector General conducted a limited review of SBA's internal control review and improvement process and reported to the Administrator that SBA generally complied with OMB's guidelines.

SBA's first annual statement to the President and the Congress stated that its system of internal control in effect during the year ended September 30, 1983, taken as a whole, generally complies with the act's requirement that its system provide reasonable assurance that the stated internal control objectives

²U.S. Small Business Administration, Report to the President and to the Congress as Required by the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255), dated Dec. 23, 1983.

are met. The statement also identified 16 material weaknesses from various sources, including assurance letters from program managers. In accordance with the OMB guidelines, the SBA Administrator requested these written assurances in November 1983. Material weaknesses included the need for SBA to update, strengthen, and streamline its Standard Operating Procedures which prescribe SBA's managerial control policies and procedures for each program and administrative function. Appendix II contains a complete listing of reported material weaknesses.

IMPROVEMENTS NEEDED IN SBA'S INTERNAL CONTROL EVALUATION PROCESS

Although SBA has made positive efforts in 1983 to comply with FMFIA in accordance with the OMB guidelines, SBA needs to improve the quality of its internal control evaluation and improvement process.

SBA needs a plan for future compliance with FMFIA and the OMB guidelines

SBA accomplished its first-year FMFIA efforts without a long-range plan or agenda and does not have a specific plan for its current-year effort. OMB guidelines do not require agencies to prepare a plan on how they will implement the guidelines and the act. However, we believe such a plan with milestone dates can be a useful management tool when an agency with limited resources has a substantial amount of work to complete. It also serves as a basis for comparing actual and planned progress and analyzing deviations. Although a plan for FMFIA activities is a useful tool for any agency, it is critical for SBA because SBA is modifying the CICR system for increased use in the FMFIA process. This adaptation should be planned and accomplished in an orderly fashion.

In a draft of this report, we proposed that SBA establish a plan for its 1984-85 internal control activities. In commenting on that draft, SBA's senior internal control official agreed with the need to establish a plan for SBA's 1984-85 FMFIA activities. He said SBA is in the process of developing such a plan.

Better documentation needed on segmentation and vulnerability assessments

SBA did not adequately document the segmentation and vulnerability assessment phases of its internal control evaluation process. OMB guidelines state that as part of its internal control evaluation process, each agency should maintain adequate documentation of its activities to provide a permanent record of the methods used, the key factors considered, and the conclusions reached. SBA's documentation on segmenting consists of a list of programs and functions developed by central office management. Similarly, SBA's documentation on vulnerability assessments are

checklist forms without any narrative on the rationale behind the results.

SBA's central office management segmented SBA while conducting vulnerability assessments during the last 2 weeks of 1982. On December 21, 1982, the Associate Deputy Administrator for Resource Management requested SBA managers to identify programs and functions within their areas of responsibility. SBA instructions did not require, and program heads did not provide, any narrative comments on the rationale for selecting the assessable units or any information to demonstrate that the entire agency was covered, as required by the OMB guidelines.

The Associate Deputy Administrator's instructions also requested central office managers to conduct vulnerability assessments on the programs and functions they identified. He directed the managers to document the results of these assessments on forms that basically contained a checklist of items, but did not require any narrative to support the vulnerability assessment rankings. For example, SBA's Portfolio Management function encompasses the control, maintenance, and general administration of the entire SBA loan portfolio of approximately 415,000 loans with an asset value of about \$16 billion. The function was ranked "moderately vulnerable." Although this ranking may be appropriate, the review file does not contain any narrative documentation to support it. We believe that documentation should be such that an independent reviewer could, after examining available documentation, reach the same conclusion as the original reviewer.

The Internal Control Steering Committee re-evaluated SBA's vulnerability assessment rankings at a December 8, 1983, meeting, but did not document the rationale for the new rankings, which increased the number of highly vulnerable areas from 3 to 12.

In a draft of this report, we proposed that SBA require that internal control reviewers document the basis for segmentation and vulnerability assessment results. In his comments on that draft, SBA's senior internal control official agreed that SBA needs to more fully document the segmentation and vulnerability assessment processes. Although he expressed some concern about possible excessive documentation, he said he will require internal control reviewers to document the basis of segmentation and vulnerability assessment results in the future.

Better guidance needed

Although suggested by OMB guidelines, SBA does not have a procedures manual on how to conduct vulnerability assessments and internal control reviews. In its first-year FMFIA effort, SBA relied on training rather than on written guidance. However, as SBA continues to evaluate internal controls and expand its internal control reviews to more programs and functions, it will need

to develop uniform written guidance. Such guidance is needed because the OMB internal control evaluation and improvement process is relatively new, and most SBA employees are unfamiliar with it. The absence of a procedural manual may have contributed to the documentation problem described above.

OMB guidelines emphasize the need for personnel involved in the internal control evaluation process to have a good understanding of the process in order to make appropriate judgments on the adequacy of internal controls. OMB guidelines mention several measures for assuring this understanding such as technical assistance, training, and a procedures manual.

SBA provided its top-level central office managers some limited written guidance on doing vulnerability assessments on December 21, 1982. These instructions generally reiterated the OMB guidelines. The instructions focused primarily on how the results of vulnerability assessments should be recorded but did not elaborate on how to conduct the assessments.

Concerning internal control reviews, SBA has not developed a procedures manual on how to do these reviews. Consultants assisted in SBA's internal control review of the 503 program, which SBA plans to use as a model for future reviews. The consultants provided guidance and training to the SBA task force conducting the review. Although SBA completed this review without a procedures manual, we believe that as SBA expands the FMFIA process agency-wide, a procedures manual will help ensure a uniform approach to performing vulnerability assessments and internal control reviews. This year, SBA plans to do six internal control reviews.

In a draft of this report, we proposed that SBA develop a procedures manual for conducting vulnerability assessments and internal control reviews. SBA's senior internal control official, in his comments on that draft, agreed on the need for better guidance. He said SBA is close to finalizing a procedures manual for conducting vulnerability assessments and internal control reviews.

SBA needs to give more consideration to
ADP in its evaluation process

Internal controls over ADP are particularly important in SBA, because SBA is highly dependent on its automated systems to carry out its mission. However, SBA does not have assurance that its ADP controls are adequate because managers generally have not appropriately evaluated them. Although OMB guidelines state that managers should include a review of automated systems in their evaluations of internal controls, SBA did not assign responsibility for assessing ADP internal controls. Additionally, SBA did not establish guidelines for making such assessments.

Automated systems support essentially all of SBA's major loan programs. For example, SBA uses computer systems to maintain accounting records for about 415,000 loans with balances totaling about \$16 billion. SBA also uses computer systems to provide its management and the Congress with operating and financial information on its programs.

The OMB guidelines suggest that managers include a review of automated systems with their evaluation of internal controls. Such reviews should consider "general" controls such as data center security controls, system software controls, and ADP unit organizational controls. Additionally, managers should consider ADP "application" controls which include controls over data input, processing, and automated data output. However, we found SBA managers generally did not evaluate either type of ADP control in performing the internal control evaluation process. For example, the task force which conducted the internal control review of the 503 Program did not evaluate ADP general and application controls. According to a task force official, knowing who in SBA had the responsibility for ADP control evaluation was unclear.

We discussed the need for addressing ADP activities with the internal control coordinator, and he agreed that it should be included in SBA's internal control evaluation process. The internal control coordinator said he will recommend to the senior internal control official that responsibility for assessing ADP general controls be assigned to SBA's Office of Computer Science, and application controls to major program offices. He also plans to recommend updating the Standard Operating Procedures to include ADP control objectives and techniques and to incorporate ADP control items into the CICR system. In a draft of this report, we proposed that SBA establish procedures for evaluating ADP internal controls. In his comments on that draft, the senior internal control official said SBA is in the process of establishing procedures for evaluating ADP internal controls.

SBA needs to develop a comprehensive follow-up system

SBA currently does not have an agency-wide tracking and follow-up system as required by the OMB guidelines. According to SBA's senior internal control official, the agency is developing a tracking and follow-up system.

The OMB guidelines require agencies to establish a formal follow-up system that logs and tracks recommendations for corrective action when internal control weaknesses have been identified. The follow-up system is also intended to include target dates to correct internal control weaknesses, assist in developing plans for implementing corrections, and monitor whether the changes are made as scheduled. The guidelines state that the system would help agencies manage the overall FMFIA process and facilitate preparation of the annual statement to the Congress and

the President. The guidelines encourage using any existing follow-up system such as ones used for audit reports.

Although SBA's CICR system tracks some internal control activities, it does not satisfy the OMB follow-up system requirement because the system (1) only covers programs and functions administered at the district office level and (2) only encompasses corrective actions for weaknesses identified through the CICR process. Not all programs administered at the district office level are currently included in the system, and SBA administers some major programs at the regional and central office levels. For example:

- The 503 Program, administered at district offices, is not included in the CICR system. The program is SBA's principal economic development program and includes over 2,000 loans, with a total SBA guarantee of \$385 million since its inception in 1981.
- The Surety Bond Guarantee Program is administered at the regional office level. Under this program, SBA guarantees a portion of a surety company's bonds issued to small businesses which cannot obtain bonding without the guarantee. In fiscal year 1983, SBA guaranteed 7,703 bond contract awards, with an SBA bond guarantee share of \$567.4 million.
- The Small Business Investment Company Program, administered by SBA's central office, makes venture capital available to small businesses through Small Business Investment Companies. Outstanding SBA loans for the program total over \$1 billion.

In a draft of this report, we proposed that SBA establish a tracking and follow-up system. In commenting on that draft, SBA's senior internal control official agreed that SBA needs a tracking and follow-up system to monitor progress in correcting internal control weaknesses. He said SBA is close to establishing such a system.

SBA needs to coordinate use
of the CICR system with OMB

SBA relied on its CICR system to support the internal control review process with respect to SBA district office activities. Also, SBA plans to use the system in completing future annual assessments. An independent evaluation of the CICR system has shown that it does not meet all of OMB's requirements. SBA should work closely with OMB as it modifies the CICR system to assure that such modifications meet internal control evaluation requirements in the OMB guidelines.

SBA's plans to increasingly use the CICR system in its internal control evaluation and improvement process will have to

be accompanied by changes to the system, and SBA may ultimately be able to use the CICR system to satisfy components of OMB's prescribed evaluation process. However, until SBA makes the necessary changes and obtains OMB approval, it will need to use other means to comply with the OMB guidelines as required by the act. For example, until SBA incorporates regional and central office programs into the CICR system, the system will not satisfy OMB requirements dealing with agency-wide matters. OMB's guidelines require agencies to have a formal follow-up system that logs recommendations and target dates and tracks scheduled changes. Although the CICR system contains elements of a follow-up system, it does not track corrective actions for weaknesses identified outside the system--such as weaknesses in headquarters' operations.

Other changes are needed to the CICR system to make it more consistent with OMB guideline requirements. An October 25, 1983, report by the accounting firm, Peat, Marwick, Mitchell, & Co. mentioned a number of enhancements it felt SBA should make so that the system could better comply with OMB guideline requirements. For example, the report points out that, although required by OMB, the CICR system does not contain documentation on the thought process used to segment the agency or do vulnerability assessments.

In a draft of this report, we proposed that SBA coordinate use of its CICR system with OMB and obtain OMB's approval for its use. In commenting on that draft, the senior internal control official said SBA has coordinated its CICR efforts with OMB, and it will continue to do so in the future. He also stated that SBA would obtain OMB's approval as SBA increasingly decides to use its CICR system to comply with the OMB guidelines.

SBA HAS EVALUATED ITS ACCOUNTING SYSTEMS

SBA reported in its annual statement that its accounting systems, taken as a whole, conform in all material respects to the Comptroller General's principles and standards. In support of this statement, SBA's Office of the Comptroller stated that it has resolved all weaknesses identified in two comprehensive Inspector General reports on SBA's accounting systems. Additionally, the Office of the Comptroller

- identified or inventoried all SBA accounting systems;
- undertook efforts to redesign two of its accounting systems;
- completed internal reviews, some of which pertained to the Comptroller General's principles and standards; and
- is developing a tracking and follow-up system for accounting system deficiencies SBA identifies in its compliance evaluations.

Although SBA made progress this year with regard to its accounting system compliance efforts, Inspector General audits of accounting systems are not necessarily recurring. The two Inspector General audits were not done in direct response to the act. To assure continued compliance, the Comptroller plans to conduct future compliance reviews of the accounting systems.

Although SBA has not developed a complete methodology for its future accounting system compliance reviews, SBA recognizes the importance of testing. In his section 4 statement, the SBA Administrator said that an important part of future accounting system reviews will be the reliance upon testing transactions, which should indicate whether systems operate as designed. The Inspector General's accounting system reviews also included testing.

We agree that an effective testing program can show whether systems operate consistently, effectively, and in accordance with established policies and procedures. In our audit work at federal agencies, we have frequently noted accounting systems operating differently from the manner specified in their design and even differently from the manner responsible officials believed them to be operating.

CONCLUSIONS

After a slow start, SBA has made progress in implementing FMFIA and related OMB guidelines. In his year-end statement, the Administrator reported to the Congress and the President that taken as a whole, SBA's system of internal controls generally complies with the act's requirement that its system provide reasonable assurance that the stated internal control objectives are met.

As SBA makes further progress in implementing the internal control and accounting system requirements of the act, in correcting known weaknesses, and as it makes the improvements it has planned in response to our review, SBA should have a more meaningful basis for concluding as to whether its internal controls and accounting systems meet the objectives of the act.

In providing official oral comments on a draft of this report, SBA generally agreed with our findings, conclusions, and proposed corrective actions contained in that draft and indicated that it is taking actions as discussed earlier to address our concerns. Therefore, we have not included any recommendations in this report, but we plan to monitor progress in these areas as part of our continuing reviews of federal agencies' implementation of the act.

MATERIAL WEAKNESSES REPORTED
IN SBA'S ANNUAL STATEMENT AND
CORRECTIVE ACTIONS TAKEN OR PLANNED

<u>MATERIAL WEAKNESS</u>	<u>CORRECTIVE ACTION TAKEN</u>
<p><u>Finance and Investment Division</u></p> <p>1. <u>Disaster Assistance Program</u></p> <p>Material weaknesses existed prior to a major geographic and functional reorganization of the Disaster Assistance Program in 1982. These weaknesses centered around the areas of Program administration and management personnel practices, adherence to Standard Operating Procedures, and delivery system control.</p>	<p><u>Finance and Investment Division</u></p> <p>1a. <u>Disaster Assistance Program</u></p> <p>Completely revised the Program's regulations, verification, and lending Standard Operating Procedures (SOPs), loan forms, and flood insurance requirements.</p> <p>Revised the Program delivery system, geographically and functionally, by implementing the area concept, and staffed area offices with permanent employees dedicated solely to disaster loan making.</p> <p>Trained staff.</p> <p>Started the process of automating controls and lending and management information systems.</p> <p>Revised and standardized basic Job descriptions.</p> <p>Instituted an internal control review system for Disaster Program area offices which provides for an independent review of technical functions by various technical experts independent of the Disaster Program function.</p>

2. Small Business Investment Company (SBIC) Program

SBA licenses, regulates, and provides financing to privately owned and operated small business investment companies that in turn, provide equity capital and long-term financing to small businesses. In some instances, SBA did not implement the designed administrative control procedures. SBA licensed SBICs with inadequate and unqualified management, and insufficiently developed or disclosed operating plans. Also, SBA financed SBICs that did not demonstrate need, and lacked ability to repay.

2a. Small Business Investment Company Program

SBA now requires field evaluations of prospective SBIC owners and managers, and it has tightened SBIC management criteria.

SBA now requires more comprehensive operating plans and statements of need in order for SBICs to obtain licenses.

SBA uses a more comprehensive liquidity test.

SBA requires increased detail in investment plans.

The financial condition of licensees is being more closely scrutinized. (Special covenants are being used for SBICs with weaker credits including, in some cases, non-subordination.)

Where necessary, SBA withholds financing to force regulatory compliance.

Minority Enterprise SBICs, called MESBICs, are now permitted to apply for financing only after a substantial part of their initial private capital is actually invested and committed to eligible small businesses.

SBA finalized Revision 6 of the SBIC regulations. It raised the minimum capital requirement for licensing, tightened the inactivity prohibitions on licensees, and lowered the capital impairment threshold for MESBICs.

3. Certified Lenders Program (CLP)

Under CLP, SBA certifies lending institutions with proven skills to submit complete guaranteed loan applications to SBA. In return, SBA provides them accelerated loan processing. CLP lenders were submitting an unacceptable number of incomplete applications. These deficient applications led to extra processing costs.

4. Loan Liquidation

SBA sells collateral and other available assets of a borrower or endorser whose loan is in liquidation to recover funds due SBA. Some cases in liquidation are allowed to drift with no action taken. Lack of action can equate to waste of assets.

3a. Certified Lenders Program

SBA conducted training sessions for CLP lenders in all regions and is developing additional training material.

SBA issued revised lender certification and decertification criteria. These criteria emphasize quality performance.

SBA has also issued a revised SOP. This SOP directs both SBA staff and lenders in processing and servicing CLP loans.

CLP record-keeping activities have been computerized.

4a. Loan Liquidation

SBA amended the "Loan Liquidation" SOP in late 1982 to require a formal and milestone liquidation plan. The revised SOP requires regular reviews of liquidation cases by the district supervisor to ensure that "drift" does not occur. Because the typical liquidation cycle is about 2 years, the effects of revising the SOP will not be fully evident for about a year.

5. Loan Servicing

SBA guarantees loans made by banks to eligible small businesses.

Field visits should be made to these banks, and a satisfactory control system for such visits should be established. Field visit reports regarding visits to participating banks were frequently too general and/or did not contain an evaluation of bank servicing. Furthermore, frequently, no visit control system was in place. Inadequate knowledge of a bank's practices can result in loss of assets.

Minority Small Business and Capital Ownership Development Division

6. 8(a) Program

Pursuant to Section 8(a) of the Small Business Act, SBA contracts with other federal government agencies to supply goods and services those agencies need. SBA then subcontracts the actual performance of the work to small businesses owned and controlled by socially and economically disadvantaged individuals.

SBA needed to significantly improve the administrative controls designed to ensure an equitable distribution of 8(a) contracts among eligible companies in the Program. Furthermore, closer administrative oversight of the contractors' performance was needed.

5a. Loan Servicing

SBA revised the "Loan Servicing" SOP in December 1982 to provide detailed instructions to field personnel on the frequency of bank visits, the content of the report, and the priority of visits. The revised SOP requires control of the visits and describes certain minimum satisfactory systems. The revision went to the field in mid FY 1983; improvement should be evident in FY 1984.

Minority Small Business and Capital Ownership Development Division

6a. 8(a) Program

SBA has re-drafted the Standard Operating Procedures to reduce the extent of optional actions and to prescribe specific procedures and controls to be applied in all instances.

Responsible personnel, as part of their internal control responsibilities, will be charged with assuring adherence to the new procedures and implementation of the prescribed controls.

Procurement and Technical Assistance Division7. Procurement Automated Source System (PASS)

PASS had design and implementation deficiencies which limited its effectiveness in achieving its planned objectives. A current backlog of approximately 12,000 business profiles had not been entered into the data base; the basic systems hardware and software were outmoded and needed updating; and provision had not been made to measure the productive results of the system.

MATERIAL WEAKNESSESFinance and Investment Division1. Loan Processing

SBA personnel do not sufficiently analyze loan application packages and document the rationale behind loan approvals. Consequently, SBA could approve loans to ineligible applicants and incur a waste of assets.

Procurement and Technical Assistance Division7a. Procurement Automated Source System

SBA has taken action to improve the PASS system. It plans to have the new system in the hands of a qualified operating contractor by the beginning of FY 1985.

CORRECTIVE ACTION PLANNEDFinance and Investment Division1a. Loan Processing

SBA plans to revise SOP instructions on documentation requirements. The revision has been prepared, and clearance is expected by the third quarter of FY 1984.

SBA will continue to monitor CICR reports for compliance and adequacy of corrective action plans.

SBA staff will also evaluate overall lending activities for adherence to quality lending directives.

2. Loan Servicing

SBA is required to examine all documents and the actions of the participant within 30 days of the time in which SBA is asked to honor the guaranteed portion of a loan. The review is to ensure that the loan was disbursed and serviced in accordance with the loan authorization and regulations. The post-purchase reviews are not made in all cases, are incomplete, or are not made within the prescribed time limit of 30 days. This can result in SBA's not declining liability and thereby wasting assets.

Minority Small Business and Capital Ownership Development Division

3. Advance payments

Responsible program officials do not always receive, review, and analyze monthly bank statements required from 8(a) firms as a control over advances. SBA makes advance payments to 8(a) firms to assist them in meeting financial requirements pertinent to the performance of specific contracts.

2a. Loan Servicing

Examine CICR results to determine where individual field office deficiencies exist in cooperation with the Office of General Counsel during the second quarter of FY 1984.

Devise and provide new CICR tracking instructions and checklist items by the third quarter of FY 1984.

The Offices of General Counsel and Finance & Investment with regional staff are considering appropriate measures to achieve better compliance.

Minority Small Business and Capital Ownership Development Division

3a. Advance Payments

SBA is revising SOPs to mandate full compliance with the requirement to obtain and analyze bank statements and reconcile them to the advance payments ledgers. Completion is expected by July 1984.

Program managers are being reminded that maintenance of sound internal controls is subject to evaluation under established rigid performance criteria.

CICR has been updated to include as checklist items all the control techniques needed to reflect the provisions of laws, rules, and SOPs. Inspection of the control techniques and documentation commenced in November of 1983 and will continue throughout the balance of FY 1984.

4. Business Development Expense

SBA spends millions of dollars annually in business development expenses to help 8(a) firms become viable enterprises. To ensure that these funds are not misused, the checks to cover the equipment purchases are required to be made payable to the equipment vendor and the 8(a) firm jointly. In a significant number of instances, SBA makes the checks payable only to the 8(a) firm.

5. 7(j) (Call Contracts) Program

SBA does not properly review required consultant reports for sufficiency, quality, and responsiveness to contract provisions. Section 7(j) of the Small Business Act authorizes SBA to initiate, organize, and maintain a management counseling service. Under this authority, in FY 1983, SBA placed about \$10 million of grants, agreements, and contracts to furnish management and technical aid, such as accounting, to SBA clients and other eligible small firms.

4a. Business Development Expense

SBA will revise SOPs to ensure that payments from the control account for equipment are made payable jointly to the equipment vendor and the 8(a) firm. Revision is in progress.

SBA will require responsible management to conduct periodic follow-up reviews to ensure that this control technique is consistently implemented. The control technique will be monitored during FY 1984 CICRs.

SBA plans to do an internal control review of the business development expense activity during FY 1984. A complete internal control review of business development expenses is tentatively scheduled for the third quarter of FY 1984.

5a. 7(j) (Call Contracts) Program

SBA will conduct a complete internal control review of the 7(j) program. FY 1983 CICR results provided specific information which will enable SBA to immediately address correction of this control weakness.

Procurement and Technical Assistance Division

6. The Certificate of Competency Program

A Certificate of Competency issued by SBA certifies that the small company has the capability to perform a specific government procurement or sale contract. SBA needs additional controls to ensure that Certificate of Competency plant visits, financial surveys, and monthly reviews of financial and contract progress reports are performed in a timely and effective manner.

Management Assistance Division

7. Small Business Development Centers (SBDC) Program

The SBDC Program is a university-based small business assistance program delivered through Cooperative Agreements between each entity and SBA. SBA's Office of Inspector General audits this activity. Possible material weaknesses are in the internal control process centering around the frequency of these audits. Further, the existing internal controls need to be strengthened and monitored.

Procurement and Technical Assistance Division

6a. The Certificate of Competency Program

SBA has initiated interim actions to strengthen controls. SBA will do a comprehensive internal control review to identify any additional controls that may be needed. The internal control review is presently scheduled to start in the second quarter of FY 1984.

Management Assistance Division

7a. Small Business Development Centers Program

SBA will establish a policy that each SBDC shall be financially and programmatically audited periodically. On a discretionary basis, some SBDCs may be subject to annual review in the event circumstances warrant. At the same time, additional internal monitoring and evaluation will be strengthened.

The SBDC Program will be subjected to a comprehensive internal control review, commencing in the second quarter of fiscal year 1984 with results expected by the third quarter. Implementation of internal control review results will begin during the final quarter.

Office of Computer Sciences
Division, Assistant
Administrator for
Administration

8. Computer Security

The security of the Computerized Loan Accounting System, with regard to access and update, needs to be strengthened to prevent unauthorized access. This problem will be of greater concern as mini and micro computers are put to use throughout SBA.

Agency-wide

9. Standard Operating Procedures

SBA needs to update, strengthen, and streamline its SOPs. SOPs prescribe SBA's administrative and managerial control policies and procedures for each program or administrative function.

Office of Computer Sciences
Division, Assistant Administrator
for Administration

8a. Computer Security

SBA is developing a comprehensive set of user passwords to prevent unauthorized users from breaching the security of the system. The immediate problem should be resolved in early February 1984. An internal control review of selected segments of the ADP system is scheduled for 1984.

Agency-wide

9a. Standard Operating Procedures

Revise and update SOPs as an integral part of each internal control review in FY 1984 and FY 1985.

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